No. 504. 192.

Brief of Coombs & Taylor for Pet

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BRIEF OF PETITIONERS.

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SUPREME COURT OF THE UNITED STATES.

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OCTOBER TERM, 1897.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

IN THE CASE OF THE

SIOUX CITY TERMINAL RAILROAD & WAREHOUSE COMPANY, CREDITS COMMUTATION COMPANY, E. H. HUBBARD, TRUSTEE, AND E. H. HUBBARD, ASSIGNEE OF THE UNION LOAN & TRUST COMPANY, *Appellants and Petitioners,*

VS.

TRUST COMPANY OF NORTH AMERICA, TRUSTEE, *Appellee and Respondent.*

JOHN C. COOMBS, 25 Equitable Building, Boston, Mass.,
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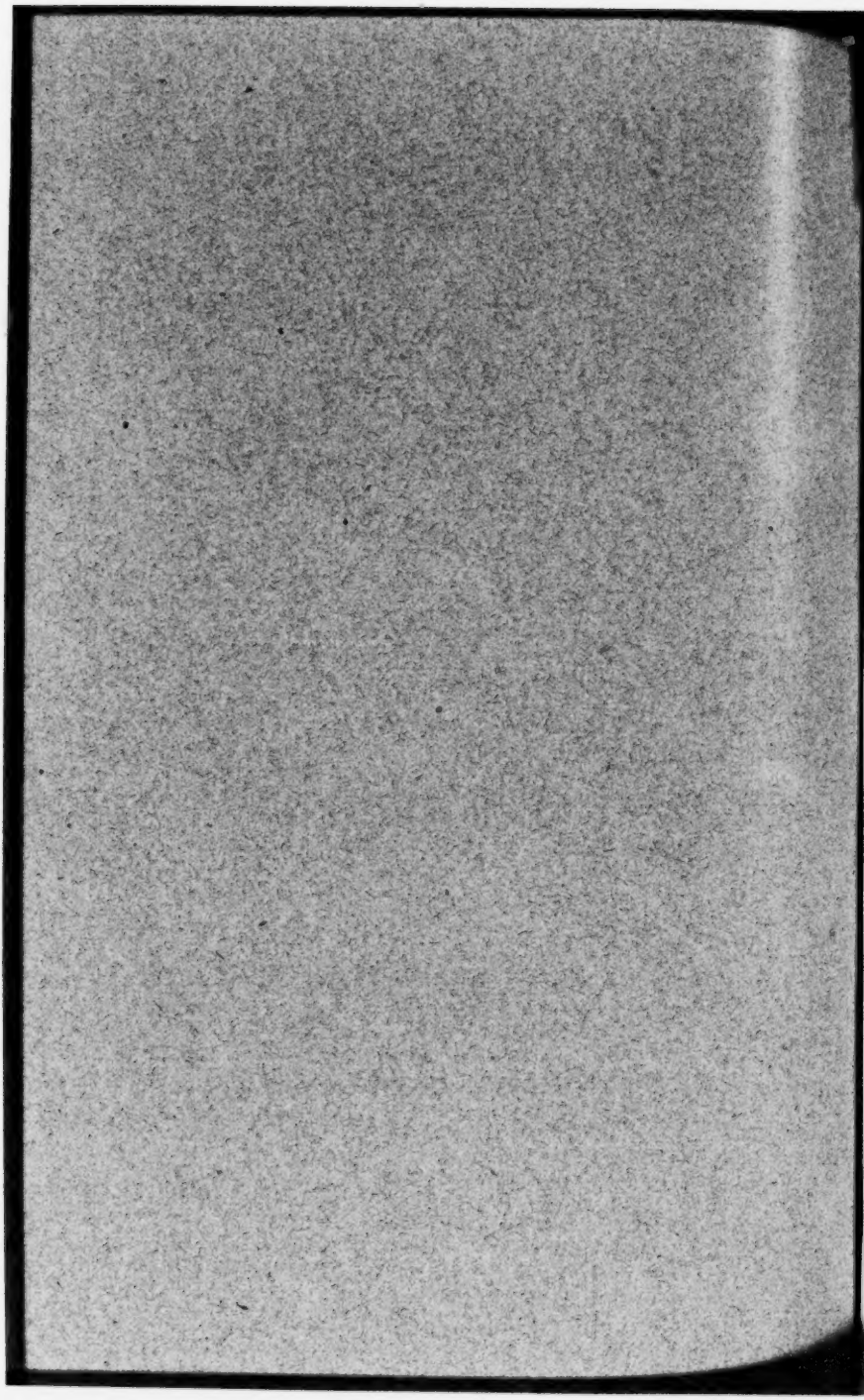

Iowa Statutes referred to are set out at end of this Brief.

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I.

THE INVALIDITY OF THE BONDS AND MORTGAGE.

To support the petition for writ of certiorari, it is essential to show, in whole or in part, the invalidity of the bonds or mortgage.

In the opinion of the Circuit Court of Appeals, both have, by necessary implication, been found to be invalid, and, expressly, a violation of law.

The complainant, in its departure from the case made by the bill and the decree in the Circuit Court, said that the

distinction between the void and voidable character of the bonds "is the first question that ought to be settled in the determination of this case." Has the Court of Appeals settled it, and, if so, how?

This is what the Court of Appeals says:

> "But the appellants insist that the mortgage is void, because the debt which it secures is in excess of the amount of indebtedness which the Terminal Company had the power to contract. The law of Iowa under which this corporation was organized provided that the incorporators must, before commencing any business, except that of their own organization, adopt articles of incorporation, and that 'such articles of incorporation must fix the highest amount of indebtedness or liability to which the corporation is at any one time to be subject, which must, in no case, except in that of risks of insurance companies, exceed two-thirds of its capital stock;' provided that these provisions shall not apply to certain classes of bonds, among which we concede, for the purpose of this discussion and decision, but do not decide, that the bonds of this corporation do not fall. McClain's Code, §§ 1610, 1611. The articles of incorporation of the Terminal Company declare that its authorized capital stock is $1,000,000, and that 'the highest amount of indebtedness to which this company shall at any time subject itself shall not exceed two-thirds of the paid-up capital stock of said company, aside from the indebtedness secured by mortgage upon the real estate of the company.' Those articles, however, did not enlarge the powers of the corporation beyond those granted by the statutes under which it was created, and, under the concession we have made, they gave it no authority to incur an indebtedness in excess of $666,667. A corporation may not enlarge its powers beyond those granted by the laws under which it was organized by claiming greater powers in its articles of incorporation. 5 Thompson on Corporations, sec. 5996. The indebtedness secured by this mortgage was $1,250,000, and each bond recited that it was one of a series of bonds not exceeding in the aggregate $1,250,000, and that

> it was secured by a first mortgage upon the property of the Terminal Company. This debt was, therefore, in excess of the statutory limitation. * * * If the aggregate amount of the bonds secured by this mortgage had been $650,000 instead of $1,250,000, they *would have been valid* in the absence of other indebtedness."

And again:

> "The statute, *whose provisions the bonds and mortgage violate*,"

and elsewhere the opinion concedes the violation of law.

Said Court finds, also, that the bondholders and mortgagee knew of this.

> "The mortgage was duly recorded * * * and from that record, and the terms of the bonds, it is a fair inference that the trust company and the bondholders had full notice that *the indebtedness secured by this mortgage*, was in excess of the limitation prescribed *by the laws of its being*."

The rule seems to be immutable, that a law-breaker does not have clean hands, and can ask nothing of equity.

> "The principle is thus applied in the same manner, when the illegality is merely *malum prohibitum*."
>
> *Reese on Ultra Vires, sec. 74, p. 114.*
>
> *1 Pomeroy, sec. 402, 1st Ed.*
>
> "Equity will never assist a party to carry into effect his own intentional violation of law."
>
> *Ibid, sec. 937.*
>
> *Reese on Ultra Vires, sec. 61.*

If, therefore, the demand of equity in this case to enforce the debt is irresistible, the obstruction is equally immovable.

This mortgage, in its single self, was unlawful—not an innocent part of a guilty aggregate, nor, in that sense, merely an excessive exercise of the power to borrow money. This debt was almost twice over such a contract as the cor-

porations of Iowa can, "by the law of their being," enter into.

The making of the mortgage was in any aspect something more than an excessive exercise of the bower to borrow money; it was an undertaking, also, to convey all the property of the company to secure a direct violation of law.

The recording of it was constructive notice of nothing, and actual knowledge of it was assurance of its invalidity. When the Circuit Court of Appeals found that the debt "would have been valid" if it had been different, that conceded that it is "invalid" as it is; between which and "void," there is absolutely no difference in law.

The complainants' brief said:

> "A void contract is dead, and no equitable inclination can give it life. There is nothing there to enforce, and the court is powerless to bring it into being."

If the bonds were not held to be valid by the exception of the proviso of the Code, then all that the complainants asked was that they should be held to be voidable, and not void.

These were the forces making for and against the status of the bonds.

It is too palpable for discussion, that the statutes and the bonds are running directly against each other. The Circuit Court thought that if he allowed them to collide, the bonds must surely perish, so he tried to sidetrack the bonds on an untenable exception to the statute. The Court of Appeals was tempted to try to do the same thing with the statute, by confining its action to authority on the part of the state to dissolve and oust the promissor and not the promissee.

But the Court of Appeals finally allowed the two to meet in full conflict, and there does not seem to be much left of either. The effect upon the bonds appears to be that they are neither valid nor voidable, but are both void and en-

forceable. The limbo of the statute is, that while it is in full force, it shall be held to run only after conscience.

The result in the Court of Appeals was reached by subordinating the action of the law upon the contract to the power of equity on the conscience of the parties. The Court affirmatively projects a promise that is void through the statutes as a vacuum, because the promissor cannot interpose the statute, which alone shows that the promise is not a substance. Such an apparition, to the mortgagor, cannot so materialize in the healthy conscience of the judgment creditor.

The appellants still think that, as matter of law, the conclusions are erroneous, and that the debt, being a deliberate violation of law, was void, and cannot be brought into existence, and enforced, and the statute suppressed by condiditions, restraints and maxims imposed upon the defendant company. There is a higher power and right than any invoked by this decision—the right of the State to have her public policy for the protection of the credit of her incorporated enterprise protected. And that a creation which the state prohibits, *in rem*, shall not be enforced in court by substituting for that issue one *in personam*.

If it be true, that where good faith, justice and equity require it, a void or voidable contract may be enforced, in behalf of one party, by equitable restraints which forbid the other party to resist or avoid it, there yet remains that it cannot so proceed affirmatively, and, on that basis, as against a party who is not thus restrained. This case shows no equity in behalf of the bondholder as against the judgment creditor.

The Court of Appeals say:

> "But it is said that the creditors of this mortgagee are entitled to a declaration that this mortgage is void, and that they have rights here superior to the

> corporation. This contention is made with special urgency on behalf of the Credits Commutation Company, a corporation of the state of Iowa, whose standing in this respect is certainly as high as any of the creditors who have appealed."

If that declaration was what the Credits Commutation Company was asking, then, possibly, that company might be held to stand in the mortgagor's shoes. It would have to stand there to do that, for no one else can assert a right to that declaration. The judgment creditor never asked it, unless in some careless use of language; he can't; he only asks that the contract be not enforced as against his lien, or allowed to take all the assets.

He goes further, and will concede that if his indebtedness had been contracted after the mortgage, but with any intent to attack the mortgage and get his pay in that way, equity might be loth even to protect his lien.

Indeed, he did go much further; he conceived that equity might be reluctant to protect even an innocent lien, if the consequences must be to discharge the obligations of the mortgagor to the mortgagee; or, if even it would let the judgment creditor into priority of lien. So he made the offer for equality, that the invalidity of the mortgage should not impair the debt, and that he would wave his own lien.

There is no novelty or paradox in the position in which the court places the bonds, or in the decision, to which the judgment creditor excepts. The novelty in his own offer anticipated, and fits, the situation. If no court has ever considered such an offer, it is safe to say that no court ever had a chance, and, on the other hand, no such conspicuous and flagrant a violation of law, if any appears to have been hitherto affirmatively enforced in equity.

Is it necessary to go to the extent of the Court of Appeals and distinguish the violation of law for reward, and affirmatively enforce the lien of an unlawful mortgage, against the

free conscience and in priority of the lien of other creditors whose unconscious money went into its enhancement?

II.

THE ENFORCEMENT OF THE BONDS AND MORTGAGE RESTS IN EQUITY ALONE.

The Court of Appeals, after conceding the invalidity of the bonds, and stating carefully and freely, even generously, the contentions of the appellants, as if the strength of the court rejoiced in the difficulties it encountered, made an answer invoking the equities of the case.

To keep in mind the extent to which the Court of Appeals goes in reliance upon its equity powers, the judgment creditor begs leave to reprint its answer to the contentions of the defendant Terminal Company. It is worthy of much repetition.

> "This is a suit in equity. The Terminal Company has received the full benefit of the proceeds of these bonds, and it obtained this money upon the faith of this mortgage. The creation of the debt and mortgage were not without the general scope of its powers, but they were the result of an excessive exercise of one of those powers. The corporation had, as we have seen, the general power to borrow money, and to secure its repayment by a mortgage. If the aggregate amount of the bonds secured by this mortgage had been $650,000 instead of $1,250,000, they would have been valid in the absence of other indebtedness. The bonds and mortgage did not, like the lease in *Thomas vs. Railroad Co.*, 101 U. S. 71; *Pennsylvania Railroad Co. vs. St. Louis, Alton, etc., Railroad Co.*, 118 U. S. 290, 309; *Oregon Railway and Navigation Co. vs. Oregonian Railway Co.*, 130 U. S. 1, 23; and *Central Transportation Co. vs. Pullman's Palace Car Co.*, 139 U. S. 24, 50, disable the corporation from performing its obligations to the Government, and to the public, nor were they, like those leases, beyond the scope of the general powers of the corporation that made them. * * * The creation

of this indebtedness, and the execution of these bonds, and this mortgage, involve no moral turpitude. The articles of incorporation, and the mortgage, were spread upon the proper public records, so that all who subsequently dealt with the corporation could see what it had done. The bonds and mortgage had in them no element of fraud, deceit, or misrepresentation. They were not evil in themselves. The corporation does not offer to return the moneys which it received upon this mortgage, but seeks to retain all its benefits, and to repudiate all its burdens. It will be soon enough for the chancellor to stay his hands from the enforcement of these contracts, and soon enough for him to set them aside, when the corporation returns to the complainant the moneys it received upon them. Until then, good faith, justice and equity demand their enforcement. A man cannot plead his own wrong to relieve himself from the obligations of an executed contract, whose benefits he retains, nor is it any defense for a private corporation against the enforcement of an executed contract whose benefits it holds, that while its execution was within the general scope of its powers, it involved an excessive exercise of one of them. While it retains the benefits of such a contract, it silently affirms, and may not be permitted to deny, its validity. *National Bank vs. Matthews*, 98 U. S. 621; *National Bank vs. Whitney*, 103 U. S. 99, 102; *Humphrey vs. Patrons' Mercantile Association*, 50 Ia. 607, 610, 612; *Garrett, Trustee, vs. Burlington Plow Co.*, 70 Ia. 697, 701; *Warfield vs. Marshall County Canning Co.*, 72 Ia. 666, 672; *Manchester & L. R. R. vs. Concord R. R.* 20 Atl. Rep. 383; *Poole* vs. *West Point Butter and Cheese Association*, 30 Fed. Rep. 513, 520; *Allis vs. Jones*, 45 Fed. Rep. 148, 150; *Parish vs. Wheeler*, 22 N. Y. 494; *Hays vs. Galion Gas Light and Coal Co.*, 29 Oh. St. 330, 340; *Bissel vs. Michigan Southern and Northern Indiana Railroad Companies*, 22 N. Y. 258; *McCluer vs. Manchester and Lawrence Railroad*, 13 Gray, 124; *Bradley vs. Ballard*, 55 Ill. 413, 418; *Rutland & Burlington Railroad Co. vs. Proctor*, 29 Vt. 93 Nor is the innocence or ignorance of the creditor essential to the maintenance of his suit to

enforce such a contract. In *National Bank vs. Matthews, supra*, a bank had made a loan on the security of a note, and a mortgage upon real estate, under the form of a deed of trust, in violation of sections 5136 and 5137 of Revised Statutes, and was proceeding to enforce collection of its debt by a sale under the trust deed, when one of the state courts enjoined the sale at the suit of one of the mortgagors, on the ground that the loan by the bank on real estate security was forbidden by law, and the trust deed was void. The Supreme Court reversed that decree, and allowed the bank to enforce its contract. In *Humphrey vs. Patrons' Mercantile Association, supra*, the Supreme Court of Iowa compelled a corporation to pay to the guilty agent who had contracted it, an indebtedness in excess of the limitation prescribed by the statute, and in *Garrett, Trustee, vs. Burlington Plow Co., supra*, that court enforced the collection of a debt in excess of the statutory limitation against a corporation, and in favor of its directors, by the foreclosure of a mortgage which the latter had caused the corporation to make to secure themselves. These decisions do not rest upon the principle of estoppel, nor depend upon the creditors' ignorance of the excessive indebtedness. They stand upon the rule that 'he who seeks equity must do equity,' and upon the principle that one may not, at the same time, accept the benefits and repudiate the burdens of his contracts."

It is safe to say that this is where the defendant appellant, Terminal Company, lost its case.

It is equally true that, without this, the case would have been decided the other way. This is all immaterial, if the bonds are not invalid, and it is submitted that the equity invoked does not make against the judgment creditor in the least.

In the preceding quotation, the court says: "The creation of the debt and mortgage were not without the general scope of its powers, but they were the result of an excessive exercise of one of those powers," and upon this distinction turns the case, and rejects our long list of authorities.

In the case of *McPherson vs. Foster Bros.*, 43 Iowa, 48, the court construed the following language, to wit:

> "No county, or other political or municipal corporation, shall be allowed to become indebted in any manner, or for any purpose, to an amount in the aggregate, exceeding five per centum on the value of the taxable property within such county, or corporation—to be ascertained by the last state and county tax lists, previous to the incurring of such indebtedness,"

And, in the opinion, said:

> "What is the effect of the inhibitory constitutional and statutory provisions upon the indebtedness which exceeds the prescribed limits? (p. 56). * * This limitation, we argue, is a direct and positive prohibition (p. 57). * * There is no distinction in reason between the cases of an entire absence of enactment conferring power, and a prohibition of its exercise beyond a certain limit. They are in fact one and the same case. In the first instance, power is not granted, and is not, therefore, possessed. In the other, it is expressly withheld, and its exercise prohibited, and is, therefore, not conferred. There is in each case a total absence of authority (p. 58). * * It is equally plain that if power be conferred to be exercised to a certain extent, and no farther, when the limit is reached, the power ceases. These principles are evident, and do not require the support of authority. No other rules which keep corporations in subordination to the state, or be in harmony with the fundamental doctrine above announced, namely: all power of corporations is derived from positive enactment (p. 58). * * We have established above that a condition or limitation upon a power whereby it ceases at a certain point, as effectually defeats its exercise beyond the limit, as though no power had been created at all (p. 59). * * When the limitation is passed, there is the same absence of power as though none had ever been conferred. Otherwise, the condition in limitation would be without effect (p. 59). * * *Power is not only withheld, but a prohibition is placed upon its exercise* (p. 63). * * It is a pro-

> hibition upon the exercise of the power, by forbidding the legislature to confer authority upon municipalities to create indebtedness beyond a certain limit. The creation of such an indebtedness is not only unauthorized, but illegal, and contrary to the settled policy of the State as declared in the Constitution (p. 63)."

This rule of construction by an Iowa court, by analogy, destroys the distinction made in this case against us.

The Minnesota Supreme Court, in *Kraniger vs. Peoples Building Society*, 61 N. W. R. 904, held, page 906:

> "But there can be no distinction in principle between a case where the charter, or articles of association, prohibit a thing altogether, and where it is prohibited beyond a certain limit. In the one case, there is a total absence of authority to do the thing at all, and in the other, a total absence of authority to do it beyond a certain limit, and after that limit is reached there is as much an absence of authority in the latter case as there was in the former."

This distinction of the Court of Appeals ought not to prevail in a case like this, where the bonded indedtedness, as a single transaction, is, and upon its face proclaims itself to be, a deliberate violation of law. Especially is this true in a case purporting to be determined on relative equities.

III.

THE RIGHT OF THE JUDGMENT CREDITOR TO PROTECTION UNDER THE STATUTE IS NOT IMPAIRED BY ANY RIGHT WHICH THE STATE MAY HAVE TO DISSOLVE THE DEFENDANT TERMINAL COMPANY.

The foregoing is the whole argument of the court on the question of the enforcibility of the contract, except an omitted part which is in discord with, and separable from, the rest. It is this:

> "The statute, whose provisions the bonds and mortgage violate, prescribed no penalty for such a viola-

> tion. It did not declare that bonds and mortgages issued to secure an indebtedness in excess of the limitation it fixed should be void. Since the legislature imposed no such penalty, it is not the province of the courts to do so. The remedy for the violation of this statute is not the destruction of the contracts which evidence it, but the ouster and dissolution of the corporation at the suit of the state. The state alone can complain of it, and the debtor cannot usurp its functions. *National Bank vs. Matthews*, 98 U. S., 621, 629; *Fritts vs. Palmer*, 132 U. S., 282, 292; *Logan County National Bank vs. Townsend*, 139 U. S. 67, 76; *Thompson vs. St. Nicholas National Bank*, 146 U. S. 240, 251."

This point is entirely independent. It is taken from the complainant's brief, and appears to have been availed of by the court for whatever it may be worth. It was pressed in the Circuit Court, and was there ignored. If it is good, it is good enough; if not, it is submitted, it mars the opinion. It renders unnecessary and irrelevant, and is even inconsistent with, all the equitable considerations on which the decision in the Court of Appeals is declared to rest. It is the same in its relation to the concessions made in the statement and premises of the opinion for the benefit of the contentions of the appellants. It deals with the statute and the contract, and not with any good faith, justice or equity, that demand the enforcement of the contracts, nor with conscionable restraints which should be imposed upon the parties. There is no equity in it. It undertakes to meet law with law, just as did the opinion of the Circuit Court. It is interpolated only in the argument against the defendant Terminal company, and is not referred to in the reasons for deciding against the judgment creditor. It is not sound in reason.

It is true that the statute prescribes no penalty for perpetrating the offense; but it couldn't, for it purported to prohibit its commission; it rendered punishment for violation impossible. To have prescribed a penalty would have vali-

dated the violation. That is the ordinary construction. There is but one penalty which could be prescribed that would not have that effect. It is the one the complainant suggested, and the Court of Appeals seemingly adopts it as necessary to avoid the obligation. It is said that if the legislature intended the violation to be void, it should have said so; but a declaration that the unauthorized indebtedness should be void, would be absurd. It would add to a statute, which now reads, in effect, that an Iowa company can, in no case, subject itself to any such indebtedness, the contradiction, "and *if it does*, the debt shall be void"—a Hibernianism which, for reasons on its face, cannot be regarded seriously.

The statute is a declaration of a prohibitory public policy, "in no case" to be violated; and, to secure this, it incapacitates any voluntary commission of the offense. To effect that, it had to stop where it did.

Reese on Ultra Vires, sec. 69, p. 102.

Sharpe vs. Teese, 9 N. J. L. 352.

It is said that it is not the province of the court to declare this indebtedness to be void. The court can't do so. If the court could do that, it could declare it to be valid, and the Court of Appeals does not attempt to do that. But isn't there a little inconsistency beyond that? After declaring that it is not the province of the court to declare the debt to be void because the statute doesn't say so, it is immediately added that the remedy is "ouster and dissolution *in a suit* by the state." Does the statute say that, either? Surely the death penalty is not the only one which the court can inflict, where none is prescribed?

It may be that such a suit in behalf of the State would lie; but would its success atone for the violation, and thus invalidate the debt? If so, it would become worthless in the

very judgment that legalized it; for there would no longer exist a debtor to answer to the precept to enforce it.

The cases cited on this point are dicta, and not direct authority. The task would, probably, be hopeless to find a precedent in which the United States, or a State, has ever even tried to oust, or dissolve, a corporation for violation of this, or any like statute.

The cases referred to in the opinion of the Court of Appeals are usually cited in a bunch, just as they are here. They are all national bank cases, decided by Federal Courts. The banks are the currency agents of the Government, and the latter guarantees their circulation in consideration of first liens on all their assets, and the Federal Courts have protected an exclusive control over them by the United States to an extent that distinguishes the decisions of those courts in all such cases.

The Supreme Court itself, in *Cal. Nat'l Bank vs. Kennedy*, 167 U. S. 362; *McCormick vs. Market Nat'l Bank*, 165 U. S. 538; *Bank vs. Townsend*, 139 U. S. 67, 76, limited very much what that court had said in *Bank vs. Matthews*, 98 U. S. 621, as is shown in *Dresser vs. Traders' National Bank*, 165 Mass. 120, 122, where this line of cases was recently considered. However, the point did not satisfy the courts in the decisions that contain it, and they expressly limit the enforcement which they authorize of prohibited contracts to the parties to the contract. It is hardly conceivable that a Federal Court would adjudicate a statute of Iowa practically out of existence on their federal decisions in respect to national banks, but would wait for some adjudication to that effect from an Iowa court. But the statement in the opinion, if true, is demurrable.

There are four parties whose interest, under the Iowa statutes, have been recognized by the courts: the company, its stockholders, its creditors, and the State.

Death is not a remedy. If imposed as a penalty at the suit of the State, it is not "*the* remedy" for any of the parties in interest, except the State, and, for the State, it is *a* remedy only to enforce an observance, and not to sanction a violation, of its public policy.

Among the other parties in interest, it must be conceded that the creditor has standing. Even the cases which it was thought would, by analogy, limit his interest to the protection of such claims of his own as were prior in time to the unlawful transaction, necessarily concede to him a standing.

It is submitted, therefore, that so much of the opinion as was last quoted, and is under consideration, should not be held to limit the scope and effect of the statute to a suit by the State for ouster and dissolution. And that, as between the parties, the decision may be held to rest where the opinion expressly placed it, on the equities of the case.

IV.

THE DECISION AGAINST THE JUDGMENT CREDITOR IS NOT EQUITABLE.

And thereupon the judgment creditor asks leave to reprint so much of the opinion of the Circuit Court of Appeals as considers, and purports to dispose of, his standing and defense.

> "But it is said that the creditors of this mortgagor are entitled to a declaration that this mortgage is void, and that they have rights here superior to the corporation. This contention is made with special urgency on behalf of the Credits Commutation Company, a corporation of the State of Iowa whose standing in this respect is certainly as high as that of any of the creditors who have appealed."

The court then reviews the transaction out of which the judgment grew, and from which we make extracts as follows:

> "In the latter part of the year 1889, the Terminal Company commenced to issue its promissory notes

for $5,000 each, and to negotiate them through the Union Loan & Trust Company, of Sioux City, a corporation which endorsed and sold them to banks located in the Eastern States. The proceeds of these notes were used by the Terminal Company to purchase and improve its property. Early in 1890, the aggregate amount of these notes had reached $1,250,000. It will be remembered that the Terminal Company made its lease to the Sioux City & Northern Railroad Company on December 14, 1889, and its first mortgage to the Trust Company on January 1, 1890. The bonds secured by this mortgage, with the exception of 250 of them, which were disposed of in 1892, were sold early in the year 1890, and their proceeds were used to pay some of the Terminal Company's notes, and to buy and improve its property. There were, however, some of its outstanding notes that were not paid, and as these fell due, the Terminal Company made new notes, the Union Loan & Trust Company endorsed and sold them, and with their proceeds paid the notes which were falling due. In this way, the notes of the Terminal Company which were outstanding on April 25, 1893, were renewals of, or substitutions for, some of the notes issued by that company in 1889 and 1890, but it does not appear that any of the banks which held the notes of the company in April, 1893, ever had any of the notes first issued for the original indebtedness of the corporation. The outstanding notes of the Terminal Company, on April 25, 1893, aggregated $718,000. They were held by banks located in the Eastern States, and none of them were made, or dated, earlier than January 1, 1892."

"The Credits Commutation Company, subsequently, became the owner of these outstanding notes of the Terminal Company, to the aggregate amount of $616,000. It thereupon sued that company upon these notes in one of the State courts of Iowa, obtained a judgment for their amount, and interest, on July 23, 1895, had an execution returned unsatisfied, and then intervened in this suit, which had been commenced in 1894."

To these findings the judgment creditor begs leave to add:

That it was not claimed by either side that the proceeds of notes or bonds had been diverted; and all the original proceeds, represented by both, went directly, or in renewals, into the property of the defendant Terminal Company, and that the complainant, to maintain its case on the basis of the decision of the Circuit Court, contended that, at the time of the mortgage, the property was worth twice the sum of the bonds.

And further, to quote from the findings of the opinion, as follows:

> "The mortgage was duly recorded in the office of the proper Register of Deeds of Sioux City, on February 27, 1890, and from that record, and the terms of the bonds, it is a fair inference that the Trust Company, and the bondholders, had full notice that the indebtedness secured by this mortgage was in excess of the limitation prescribed by the law of its being."

The petitioners do not claim that that recording conveyed any such notice, but say that none was needed to the mortgagee Trust Company itself, nor to actual bondholders. The court decides against the judgment creditor as follows:

> "But how can they establish any rights as against the first mortgage upon this property superior to those of the mortgagor? The equities of the appellants who own these notes cannot be higher than those of their original holders, and they became creditors of this corporation subsequent to the sale of all but 250 of the bonds, and probably subsequent to the sale of those. Subsequent creditors stand in the shoes of the mortgagor, where the prior mortgage is not obtained and accepted by the mortgagees with intent to defraud them, and this mortgage certainly was not. *Graham vs. Railroad Co.*, 102 U. S. 148, 153; *Mattingly vs. Nye*, 8 Wall. 370; *Sexton vs. Wheaton*, 8 Wheat. 229. Moreover, whether the holders of these notes became creditors before or after the bondholders did, they have established no right to attack this mortgage superior to that of the mort-

> gagor. They could maintain no superior equitable claim to attack it, unless they proved that the mortgage was made by the corporation, and was obtained and accepted by the trustee, and the bondholders, with the intent to deceive and defraud them, and that it did deceive and defraud them, and there is no such evidence in this case. They have no legal lien upon the mortgaged property prior to that of the mortgage, and the same considerations which have defeated the defense of the mortgagor make this mortgage impregnable to the assaults of these creditors. *Warfield vs. Marshall County Canning Co.*, 72 Ia. 666, 670, 672; *Garrett, Trustee, vs. Burlington Plow Co.*, 70 Ia. 697, 700, 701, 702; *National Bank vs. Whitney*, 103 U. S. 99, 103."

The difference between the strength of this and that with which the Court disposed of the mortgagor, only needs to have attention called to it. Not only so, but the answers to the two appellants are so different, that the first answer to the Court's decision against the judgment creditor is the sentence with which the Court opened its own answer to the mortgagor: "This is a suit in equity."

In law, everything or nothing goes one way in a single issue, between two parties, only, but equity is not bound to do wholesale alone. It may work out a share of justice to each of many, according to his interest, and the circumstances of his case.

The Court will be indulgent of the natural impulse of the creditor, to take warm and immediate exception to the suggestion that he stands in the shoes of the debtor in this case.

However innocent of moral turpitude the mortgagee may have been—and we concede that he was conscious of, and intended none—this mortgage was, nevertheless, a fraud, in fact, by the mortgagor against the note-holders, both those existing and subsequent ones who did not know of it; and none of them knew. It is submitted that, in no equitable sense, and for no equitable purpose, can the victim of a crime

be held to "stand in the shoes" of its perpetrator, subject to the same judgment and for the same reasons. All that the Court of Appeals said in righteousness for the bondholder against the debtor, should be more earnestly repeated in behalf of the judgment creditor, and not cited against him; for the judgment creditor and the bondholder stand side by side against the debtor, except that the judgment creditor is both more innocent, and has suffered the greater wrong.

So, even except where there is fraud, it is submitted that neither for equitable nor legal reasons, should the authorities cited by the Court of Appeals to sustain the proposition that a subsequent creditor stands in a debtor's shoes apply here. The Court cites these cases:

Graham vs. Railroad Company, 102 U. S. 148.
Mattingly vs. Nye, 8 Wall. 370.
Sexton vs. Wheaton, 8 Wheat. 229.

All of these suits were brought by judgment creditors, proceeding affirmatively in equity, to effect cancellations of prior conveyances, and settlements made by grantors, solvent at the time, and made before the debts in judgment were contracted, and they contained no offer to do any equity whatever. They are all distinguished on the vital point—that the conveyances which were attacked were all valid and lawful when made, but this mortgage at bar never was, and isn't yet; no other debt is prior or subsequent to it as a legal indebtedness on the bonds.

The mortgagee and bondholders take nothing from their contract as lawful, but everything from the grace of the Court, and the power of equity, acting upon the consciences of the parties. They have the burden, but it is not even shown that all other existing debts were contracted after all the bonds were sold; the Court expressly leaves that in doubt, with, perhaps, an inclination to the contrary. Under the record our notes clearly antedate the sale of $250,000 of

the bonds; so that the mortgage should have precedence only to the extent of a million dollars, and an accounting should be had to determine which of the bonds offered were sold subsequent to the indebtedness of the judgment creditor. More than that, the notes of the judgment creditor, by renewals and substitutions, antedate the mortgage and the sale of every single bond thereunder. And if the mortgage fail for that defect and to that extent, the amount of claims thus involved is material, and the judgment creditor has standing to raise that question. So, in no equitable sense, and for no equally equitable purpose, can it be said that "the same considerations which have defeated the defence of the mortgagor, make this mortgage impregnable to the assaults of these creditors."

The judgment creditor does not assault the mortgage, and especially not the bonds it purports to secure; he can't do so. He would have to stand in the mortgagor's shoes to do that. He can't prevent the debtor from paying, nor the enforcement of the mortgage, as against the mortgagor, however invalid. That is none of the judgment creditor's business. He can say, however, that its satisfaction out of the security shall be wholly or partially postponed to the payment of his own claim. He takes neither subject to the mortgagor's conscience, nor in acknowledgment of the mortgagee's liens or equities. The question is of his standing, simply, to assert and defend his own judgment lien as against an invalid mortgage. He attacks nobody. On the contrary he says here that if the maintenance of his legal defence would yield to him an inequitable preference over the bonds and mortgage, he will waive it, and share in equality, pro rata, with the bondholders. He does not stand in the mortgagor's shoes, nor should a Court in Equity force such uncomfortable ones upon his unwilling feet.

But the rest of the sentence is more grievous. It is sub-

mitted that the considerations that defeated the defence of the mortgagor were these: That the mortgagor made the mortgage, received the money, and promised to pay the bonds; and good faith, justice and equity demand that, until he pays as he promised, the mortgage should be enforced against him. If he seeks in equity to have the cloud of the mortgage lifted, or to stay its enforcement, equity requires him to do equity, and to pay back, as he promised, that which he borrowed on the faith of the security.

Take this out of the opinion, and there is nothing of equity left to sustain it.

Yet, what of it pricks the judgment creditor's conscience? He received nothing from the mortgagee; has done to him no wrong; has promised nothing to him; owes to him neither money, nor lands, nor precedence, nor recognition, nor duty, nor equity, nor anything which narrows the shoes that pinch or cripple the mortgagor. Neither does he ask any equity. He defends a lien at law.

So that if this mortgage should be impregnable to assault by the judgment creditor, it is submitted that it is not so for the same considerations which this opinion assigns for defeating the defendant company. This, it is submitted, also answers the suggestion of the Court of Appeals that the creditor has established no right to attack the mortgage superior to that of the debtor; for he has a lien which gives him standing, and he is free from the restraints which good faith, justice and equity, and an obligation to do equity, impose upon the mortgagor, and forbid him to defend, and on which this case is decided against the mortgagor. And, besides, the creditor offers to do equity when none can be asked of him. For what principle of equity requires an honest judgment creditor to bow at all to an unlawful contract, in which he took no part? Or, where has it been said that, in equity, it doesn't make a bit of difference whether a mort-

gage, which it is sought to enforce, is lawful or unlawful, provided the guilty mortgagor ought, in conscience, to do something for the unlawful mortgagee?

V.

THE REMAINING AUTHORITIES CITED AND FURTHER SUGGESTIONS OF THE COURT OF APPEALS DO NOT DEMAND THE DECISION RENDERED AGAINST THE JUDGMENT CREDITOR.

The authorities cited by the Court of Appeals at the end of the decision against the judgment creditor, are:

Warfield vs. Marshall County Canning Co., 72 Ia. 666.
Garrett, Trustee, vs. Burlington Plow Co., 70 Ia. 697.
National Bank vs. Whitney, 103 U. S. 99-103.

They are not cited as peculiar alone to the immediate point, but generally, there and elsewhere, as pertinent to the case, especially in connection with one other Iowa case (*Humphrey vs. Patrons' Mercantile As'n*, 50 Ia. 607), all in the complainant's brief, as if to suggest that the courts of Iowa had settled the matter. It is submitted that they appear to have been relied upon as authority for taking the court too far:

Say the court:

> "In *Humphrey vs. Patrons' Mercantile Association*, The Supreme Court of Iowa compelled a corporation to pay to the guilty agent who had contracted it, an indebtedness in excess of the limitation prescribed by the statute."

The limitation prescribed by the *statute* wasn't in issue, nor referred to in that case, but only the limitation fixed in the *articles*, which the Court of Appeals itself says is immaterial.

The same is true of

Warfield vs. Marshall County Canning Co.

Neither was any indebtedness in that case enforced. It was

an attack by a judgment creditor upon the mortgage, and his petition was dismissed. Oddly enough, so far as the statute limitation is concerned, the petitioner in that case insisted that the company should be estopped from denying that its capital was a sum which was abundantly large to bring the debt within the statutory limitation. He did not attack on the ground that it wasn't.

The Court of Appeals continues:

> "And in *Garrett, Trustee, vs. Burlington Plow Co.*, that court (Supreme Court of Iowa) enforced the collection of a debt in excess of the statutory limitation against a corporation, and in favor of its directors, by the foreclosure of a mortgage which the latter had caused the corporation to make to secure themselves."

The indebtedness enforced in that case did not, in itself, exceed the statutory limitation. That it does so in the case at bar was rightly considered by the Court of Appeals, and by the Circuit Court, as the feature which distinguished it from an excessive aggregate indebtedness, made up of parts, each of which was within the limitation.

In both of the last two Iowa cases, the courts expressly say that they *do not* understand the limitation to be insisted upon, though one of them adds that indebtedness in excess of the limitation can be enforced against the company, which is undoubtedly true, for instance, in *quantum meruit*.

The Iowa court, or any other court we know of, has never said that a single indebtedness so violating the statute has been upheld and affirmatively enforced on the contracts as such. Such a contract, proclaiming its own violation of law, and one whose violation rests on extrinsic evidence, is distinguishable, and absolutely distinguished. Where a recovery cannot be had on the instrument itself, without disclosing and proving its violation of law, recovery on the instrument is denied. Where extrinsic evidence is necessary to show such violation, the rule may be different.

The Court of Appeals adds: "These decisions do not rest upon the principle of estoppel." But *Humphrey vs. Patrons' Mercantile Association*, 50 Iowa, 607, says that it does.

The Court of Appeals says so, too, in this case: "A man cannot plead his own wrong to relieve him from the obligations of an executed contract, whose benefits he retains."

The Court continues: "Nor (do these decisions) depend upon the creditor's ignorance of the excessive indebtedness."

But, in the Humphrey case, the only Iowa case in which it is discussed, the court does expressly reserve that point, saying: "We are of the opinion, in view of the importance of upholding corporate credit *and protecting creditors who have parted with their property in ignorance of the fact* that the limit had been exceeded, that *the corporation* should be *estopped* from setting up that fact."

And again the Court says:

"Nor is the innocence nor ignorance of the creditor essential to the maintenance of his suit to enforce such contract."

As against everybody but the other party, in equity, it must be. Courts of equity do not sit to enforce conscious violation of law in behalf of the guilty and against the innocent. The case relied upon is *National Bank vs. Matthews*, 98 U. S. 621. There was a dissenting opinion. The case was afterwards limited. *Bank vs. Townsend*, 139 U. S. 67; *Dresser vs. Bank*, 165 Mass., 120; *McCormick vs. Bank*, 165 U. S. 538. *Cal. Nat'l Bank vs. Kennedy*, 167 U. S. 362. *Bank vs. Matthews* is one of the decisions, heretofore noticed, of Federal Courts, to enable national banks to realize on real estate security. The statutes thus violated are in the nature of special legislation, confined to these currency agents of the Government, and the decisions of the Supreme Court concerning them are, for the most part, special adjudications.

But this case of Bank vs. Matthews is a leading case. It goes directly upon estoppel, as does the eminent authority

from whom it quotes. And it expressly eliminates and protects everybody not parties to the unlawful transaction.

Thus, this case, and those that follow it, are affirmative authorities for the petition now presented.

Quoting from Sedg. Stat. & Const. Constr., 73, the Court says (and it is made the headnote of the case):

> "Where it is a simple question of authority to contract, arising either on a question of regularity of organization, or of power conferred by the charter, a *party who has had the benefits of the agreement cannot be permitted*, in an action founded upon it, to question its validity."

So, in Bank vs. Townsend, the power to enforce a *malum prohibitum* was expressly limited to the same parties.

Of Warfield vs. Canning Company, and Garrett vs. Plow Company, it should further be said that the principle, if not the only, issue in both, as stated by the court, was whether a creditor director, in an insolvent corporation, can avail of his position to secure a preference out of its assets to himself; and, resting on Wait vs. Buckingham, 16 Ia. 284, they decided that he can. Michigan thinks so, too. So does Virginia, and probably Missouri. Substantially, all other States think differently.

Further, in deciding against the judgment creditor, the Court of Appeals says:

> "They (the judgment creditors) have no legal lien upon the mortgaged property, prior to that of the mortgage."

But the lien of the mortgage is not legal; it is equitable only; while the judgment creditor's lien is legal, and his debt admittedly older than one-fifth of the bonds.

In this connection we ask briefly to revert to our exception to the proposition in the opinion that this mortgage and debt were only an excessive exercise of a general power on the part of the Terminal Company to borrow money.

That is what it would have been if the mortgage had been for a debt within the limitation, and, as the Court of Appeals, itself, says, "*in the absence of other indebtedness.*"

An aggregate excess of innocent debts is only an excessive exercise of a lawful power to borrow.

Any of such debts are, at worst, voidable only; for the payment of one might cure all the rest, and, above all, every one of them might have been contracted without knowledge that the limit was exceeded.

A doctor has a general power to administer poison; often he can't save life without, but he musn't give a single dose which he knows will kill. It isn't the excessive grains that are considered, nor would that view limit his act to one of an excessive exercise of a general power; the difference in degree has made it an act of the widest possible difference in kind.

But, to sustain the petitioner's offer, it is not so much the debt that the petitioner finds fault with, as the mortgage. In that paper all the excesses were concentrated. It was notice, like the bonds, that the statute was violated.

> "Resolved: That this Company make and issue, in the name and under the corporate seal of this company, 1,250 bonds, of the sum of $1,000 each." (Transcript, p. 143).

That was not merely an excessive exercise of the lawful power to borrow money. It was not only that, and something more, but it was also that and something different, a pledge of its lands in forfeiture. This is said, in part, to a point presented, but not expressly considered, by the Court of Appeals.

The Court seems to rely somewhat on the fact stated in the opinion—that the mortgage was recorded at the time, in Woodbury County, Iowa.

The Court cites *National Bank vs. Whitney*, 103 U. S. 99, 103. That case only decided that a mortgage, junior in

fact, but recorded, takes precedence of an earlier, unrecorded one.

The Court of Appeals, evidently, felt reluctant to say that, in a decision which rested on equity alone, the Eastern creditors, fifteen hundred miles away, should be held to be affected by constructive notice, when, in fact, there was no evidence, and couldn't be, that any of them knew anything about the mortgage.

But the Court carefully stated the facts, and cited the law, on which the argument of constructive notice could be inferred.

It cannot be contended that a man may validate a violation of the law by publishing notice of his attempt. The notes were each, $5,000 in amount, and each silent as to any other note. In each such transaction, the Terminal Company, necessarily, represents that its aggregate indebtedness is not in excess of law. This presumption may even be conclusive. But it has no force with the bondholders, for the face of their instruments proclaim the fact that, by them, the law is violated. The recording act does not reach the note holders. The act is not intended to give constructive notice of indebtedness against a corporation, in whole or in part; certainly not of an excessive and unlawful debt. The note purchaser is not sent to the records to find out the indebtedness of the company. In his favor, the presumption is not only *prima facie*, but conclusive, that the limit of indebtedness has not been reached. This presumption is stronger than, and will be upheld against, any constructive notice of a recorded mortgage, even if such mortgage must further be presumed, outside the record thereof, to have been satisfied, or sufficiently reduced in amount. The equity rests with the note holder. Equity never rests with contracts violative of law, against non-participating, innocent third parties.

Certainly there was no lawful record of any prior lawful lien; the judgment lien is the first one. Can a violation of law be lawfully recorded? If so, is it constructive notice of anything but its own invalidity, and, therefore, a warrant that it need not be regarded?

VI.

THE JUDGMENT CREDITOR OFFERS TO TAKE A DECREE WHICH WILL REQUIRE A WAIVER OF ALL LIENS, AND THE ADMISSION OF ALL CREDITORS TO PRO RATA PARTICIPATION IN THE ASSETS.

The Court of Appeals, in opening its refusal to protect the judgment creditor, asked: "How can they establish any rights as against the first mortgage upon this property superior to those of the mortgagor?"

The Court asks this as if inviting an answer. The judgment creditor accepts the premises, as declared by the Court, that this is a suit in equity. The decision rests upon the rule that one who asks equity must do equity. The judgment creditor says he is willing to do it, and makes an offer such as no other judgment creditor ever made, at least in any reported case, to the holders of an invalid mortgage. That distinguishes this case.

It establishes a right superior to that of the mortgagor, not against the first mortgage, for the judgment creditor does not attack it; nor against the debt, for it is not his debt. He only denies that, under the principles and maxims of equity, either of these is superior to his own, and, holding the respondent to the like duty with himself, he challenges a comparison so as to see how far the Court will proceed affirmatively in behalf of the invalid mortgage, against this valid judgment, under the circumstances of this case.

He admits that the mortgagees are guilty of no moral turpitude, and that the mortgage was not an evil in itself. The same is more true of himself, and of his own claim.

Nevertheless, the mortgage did, in fact, work a grievous injury to the judgment creditor, for more than $600,000 of his money went into the permanent improvement of the mortgagee's security, leaving not a dollar of assets, or equity, in the borrower with which to pay him, because the mortgage is too large by nearly one half. In this case, the measure of the judgment creditor's injury is almost exactly the measure in which the mortgage violates the law. A man may do, or take the benefit of, wrong without malice or responsibility, but if, after learning the evil consequences to others, he insists upon retaining the benefit to himself, though no more than is strictly due to him, there is a principle, that the innocency goes out of his case, and he is held to have adopted the wrong.

Atlantic Mills vs. Indian Orchard Mills, 147 Mass. 268.

From the hour this mortgage was made, and because of it, the representations on which the money of the creditors was obtained were false, and false through a fact which the law prohibits. The creditors did not know of the mortgage, and had every right to believe that such a mortgage could not, and did not, exist

The mortgagees knew from inference, were bound to know in law, and did know in fact, that the mortgage was too large, and, for that reason, violated the law. All the money the creditors lost, the mortgagees got the benefit of, for the sole reason that the mortgage was unlawful; and they know that, too, now, but still insist upon it. The influence which knowledge of the violation should exert, is expressly reserved in the leading Iowa case (*Humphrey vs. Patrons' Mercantile Ass'n*, 50 Iowa, 607-12), and is not denied in the other Iowa cases. It is submitted that the authorities show that, when such knowledge necessarily appears upon the face of the instrument, when compared with the statutes, it should control the equity.

Mon. Nat'l Bank vs. Globe Works, 101 Mass. 58.
Beach on Pri. Corp., sec. 740.
Claflin vs. Far. & Cit. Bank, 25 N. Y. 293-8.
Com. vs. Smith, 10 Allen, 458.
5 Thompson on Corp., sec. 6009.
Green's Brice's Ultra Vires, page 40, note a.
4 Thompson on Corp., sec. 5705.
Board of Com. vs. Potter, 142 U. S. 355.
Durkee vs. People (Illinois), 40 N. E. R. 629.

It is sometimes said that when one of two parties, equally innocent, must suffer from the wrongs of a third, it must be borne by the one who unconsciously enabled the doer of the wrong to commit it; but it has never been said that, if the offence was a violation of law, and one of the parties was a *particeps criminis*, equity would interfere to give to him a preference, and throw the whole loss on the other man.

This mortgage was, *ipso facto*, a fraud upon every noteholder, no matter whether he got his note before or after the mortgage. Every noteholder took his note under an implied warranty that the indebtedness of the company was, and would remain, within the limits of law. Each note was small in amount, and carried no information of other debts. This warranty, as to the company, becomes, under the authorities, a conclusive presumption—in this case, at least, a controlling presumption. Each noteholder was entitled to conclude his loan on the presumption, and warranty, involved in every note deal, that the lawful limit had not been exceeded. Each note sale, or loan, carries this representation—this implied warranty. The assumed integrity of each note transaction forces this presumption. To get money on these notes was fraudulent. Why? Because the money was secured with absolute knowledge of such inability to pay as to amount to an intention not to pay them. The legal limit of indebtedness always leaves one-third of the assets for gen-

eral creditors. This unlawful mortgage left nothing. Creditors may loan to a company relying on the company keeping its indebtedness within the lawful amount, and feel and be safe without security. The credit is based on the law. But a creditor comes along who knowingly violates the law and takes a mortgage too large by half. His wrong-doing is rewarded as diligence and the creditor that relied on the law gets nothing. It's all wrong, and we don't believe the courts of the land will thus teach the people how to break and evade the law.

Did the bondholders become parties to this fraud? Yes. They knew that every creditor had a right to rely on the implied warranty that the legal limit of indebtedness had not been exceeded. The assets of such a corporation are presumed to arise from a sale of its stock, which in this case brought nothing. A million dollars of stock should mean a million dollars of property. To put a million and a quarter mortgage on this property assures insolvency, and changes the legal presumption that the limit has not been exceeded into a legal fraud, and in this case, necessarily involving every noteholder in total loss. The bondholders, by a known, illegal transaction, are participants in this fraud. They are guilty of using the presumption that the limit has not been exceeded, as a trap to ensnare others for their own gain. The bondholders have but one reply to this actual fraud, namely, that their mortgage is recorded, and that we are presumed to have contracted with constructive notice. Constructive notice of unlawful indebtedness cannot be given under the recording act. The most that could be charged is knowledge up to the lawful limit. In so far as the mortgage is unlawful, its record imparts no constructive notice. In this sense, each noteholder is innocent, and each bondholder has perpetrated a fraud upon him to his injury. Upon whom will equity inflict this loss?

Reese on Ultra Vires, sec. 61.

It was urged by the bondholders that they were more careful to take security than were the creditors, and that their diligence should be protected. It is true that one of the maxims in equity is, that it protects the diligent; but diligence is the one truthful compliment that may always be paid to a wrong doer. The Court must know what the suitor was doing before it rewards his diligence.

In cases of railroad foreclosure, analagous to this, the six months' rule gives priority of lien to indebtedness contracted within that time, for certain purposes, and there is practically no limit to the priority which may be given to construction claims. This relief is administered by courts of equity by main strength, and as a function of their equity powers.

The maxim in equity, that "he who seeks equity must do equity," is a compromise between the parties enforced by the conscience of the Court. It is the same rule in equity as is another in civil polity, "that the rights of every man end where the rights of any other man begin."

There are twelve maxims in equity. Six of them are applicable to this case, and some of them point directly to the compromise or decree herein proposed. One we have already considered.

Its immediate successor is "he who comes into equity must come with clean hands." This also refers to the complainant, only; the defendant need not have clean hands. All illegality falls within this maxim, and is unclean.

Reese on Ultra Vires, sec. 69.

> "The principle is thus applied in the same manner when the illegality is merely *malum prohibitum*."
>
> *1 Pomeroy, sec. 402, 1st Ed.*

> "Equity will never assist a party to carry into effect his own intentional violation of law."
>
> *Ibid, sec. 937.*

It is admitted that United States courts have somewhat relaxed these rules in national bank cases. But, in all such cases, the rule is only relaxed as between parties whose hands are equally unclean.

On this maxim, and where the evil is prohibited by a statute of general application, equity should neither assist the defendant Terminal Company in repudiating the contract, nor the mortgagee in enforcing it; but, in the case at bar, should protect the judgment creditor, for not only is his hand the most generous and equitable, but it is the only clean one in the case.

But if the equities of the mortgagee and the judgment creditor were equal, the latter should prevail under another maxim: "Where there is equal equity the law must prevail."

The best title in the world is title by creation. The moneys of bondholders and noteholders, alike, created the assets. In that they stand alike.

The estate is insolvent, and in such case equity disposes of the fund on the theory that the contributors should be the distributees pro rata. Both of the liens in this case rest on that same equity, but the lien of the judgment creditor is both legal and equitable, and that of the bondholder is, at best, equitable only.

This includes another maxim of narrower operation: "Equity follows the law," which means that it is bound to obey the law, and as well that it observes its principles.

And again, and directly controlling, "Equality is equity." This is one of the greatest of the maxims, the universal guide in insolvencies and the distribution of funds, when the Court is not restrained by absolute legal priorities.

The last of the maxims is the one which, though not referred to, must have been in the mind of the Court of Appeals when it rested its judgment on the consciences of the parties, rather than *in rem* either against the statute to destroy it,

or, in behalf of the contract, to sustain it: "Equity acts *in personam* and not *in rem*."

Not only one, but all, of these maxims this judgment creditor asks leave to stand by the side of the alleged mortgagee and invoke.

While neither of these parties thought that the enforcement of his claim would inflict loss upon anybody else, it is a fact that the enforcement of either in priority would do so. The mortgagee's claim is illegal, but the judgment creditor asks for no more than he concedes.

This offer changes the aspect of the case. There is no longer a controversy for an exclusive priority in $1,250,000 of property, but only of the right of the judgment creditor to preserve an interest in one-third of it; and he submits that the bondholders' equities, as against him, are satisfied.

In the fifth division of its opinion, pages 40-1 of the petition for certiorari, the Court of Appeals says:

> "In April, 1893, the Terminal Company made a trust deed of all its property to the Union Loan & Trust Company to secure the payment of these notes. This deed recited that it was subject to the mortgage in suit."

The status of this mortgage should be shown. It is set out on pages 15–18 of the record. There is no evidence fixing the exact time when this so-called second mortgage was taken by the Union Loan & Trust Company. The mortgage itself purports to have been signed and acknowledged on the 24th day of April, 1893, the very day the Union Loan & Trust Company voted to make its assignment for the benefit of creditors, which it actually did on April 25, 1893. The mortgage was not made to secure any of the Terminal notes that had been negotiated through said Trust Company and that make up the notes represented by the Credits Commutation Company, petitioner herein (Transcript, pp. 78–82), nor the notes mentioned in the stipulation of the parties (Transcript,

pp. 243–4), but said mortgage purports to secure 190 other notes *of even date therewith*, aggregating $750,000. No such notes were ever negotiated. None of the notes in controversy bear even date with the mortgage, but a much earlier date.

The interests represented by the petitioners do not rest in any manner upon said alleged mortgage, nor can said alleged mortgage conclude nor preclude the petitioners from any of their rights under the issues in this case.

The first twenty-four pages of the printed record refer to an old suit brought by only a half dozen banks for the foreclosure of said alleged mortgage, and the very most that can be gotten out of that mortgage is a prejudice, if any, to the notes represented by such banks. If all of those notes should be held to be prejudiced by said procedure it would reduce the indebtedness of the Credits Commutation Company by only a few thousand dollars, if indeed any of said notes should be shown to be therein included. As that is the most and the worst that can be urged against this petitioner creditor because of the alleged second mortgage, its concession, if necessary, leaves our rights intact and the amount of the claim of the judgment creditor practically unchanged. The Court of Appeals speaks, in said fifth division, of determining the "rights of the owners of these notes under their second mortgage of April, 1893." But no such rights are asserted, and, with the exception of the first suit on the part of said six banks, no rights have been asserted under either said mortgage or said notes, and the court in making the statement that any rights thereunder were before it for adjudication lost sight of the issues, for neither the mortgage nor the notes thereby secured are in any manner presented for determination. The old suit by said six banks was long since abandoned. Entirely different notes are involved, and in no manner do they rest, nor is it claimed that they rest, upon

the second mortgage, nor is there any testimony that the second mortgage was made for their benefit, nor that the noteholders in question ever knew of or accepted the same. The allegations of the petition of those six banks is all that there is in this case touching this matter, and that petition was never introduced in evidence and cannot prejudice the petitioner creditor. For what purpose the second mortgage, referred to in the Court of Appeals, and evidently wholly misunderstood, was executed and delivered, if any delivery was made, is not shown. Even if it was formally handed into the Trust Company on the day before its failure and on the very day it voted to assign, it cannot be held to prejudice the rights of creditors who neither knew anything of it nor will have anything to do with it. Under the evidence, the first mortgage bonds should have been with the Union Loan & Trust Company as collateral security to petitioner's notes. All of such bonds after signature were there as such security but when sent to respondent for certification were never returned to the Union Loan & Trust Company as they should have been in pledge for said notes. They were wrongfully extracted by the collusion of two of the officers of the Trust Company and sold and the proceeds diverted to uses other than the payment of the notes to which they had been pledged.

Another matter should be here stated. On pages 62 and 243 of the record is a stipulation made to avoid the necessity of the taking of evidence to sustain the facts therein stipulated, to the effect that the promissory notes represented by the petitioner herein, Credits Commutation Company, "are outstanding, due and unpaid notes of the Sioux City Terminal Railroad & Warehouse Company." Since this stipulation was intended to and did do away with the taking of evidence to show the validity of petitioner's notes, it is urged that full force be given to this stipulation of their validity, even

though said construction may make against the validity of the bonds. In view of the evidence (pages 120-1-2) and this stipulation (pages 243-4), the petitioner protests against the construction of the Court of Appeals in not making its entire indebtedness renewals of the original notes antedating respondent's bonds and mortgage.

VII.

THE TERMINAL COMPANY IS A QUASI PUBLIC CORPORATION ORGANIZED UNDER CHAPTER 139 OF THE ACTS OF THE TWENTIETH GENERAL ASSEMBLY OF IOWA AND HAS NO AUTHORITY TO MORTGAGE ITS PROPERTY, AS NO SUCH AUTHORITY IS GRANTED.

We allege "that under the laws of Iowa said corporation, the Terminal Company, is not authorized to mortgage its property or franchises or after-acquired property nor do its articles purport to grant power to mortgage its franchises." (Transcript, pp. 66, 73.)

Article 3, page 189, reads:

> "This company shall have power to construct, operate and maintain one or more lines of railway within the corporate limits of Sioux City, Iowa, with all needed side-tracks, depots, yards, warehouses, storage-houses, elevators, and all other needed terminal facilities, and shall have power to acquire by purchase or condemnation, all needed grounds for right of way, depot purposes and side-tracks, wood and water stations, and to hold, use and control over same, and shall have power to construct, operate and control one or more lines of railway, from the depots and yards of the said company in Sioux City, one to run in an easterly direction to the east line of Woodbury county, Iowa, one to run in a westerly direction to the Big Sioux River, and one to run in a northerly direction to the Iowa state line. And shall have power to lease grounds and buildings, and to purchase and hold all needed improvements for the

use and purpose of said company, and to mortgage, lease or sell the said grounds and improvements thereon."

It is well settled that by reason of the public duties and character of a railway company, such corporation "cannot make a valid mortgage of its property without the consent of the State, for by foreclosure of the mortgage, the corporation would become disabled from performing its duties to the public."

2 Morawetz on Corporations, sec. 1120.

5 Thompson on Corporations, secs. 6137, 6131.

"The same rule undoubtedly applies to any other company which has been empowered by the State to establish its works through exercise of the right of eminent domain, or which has received State aid in its enterprise in any other form."

2 Morawetz on Corporations, sec. 1120.

Reese on Ultra Vires, sec. 140.

The court will notice that this Terminal Company has the right of eminent domain by its articles, whether a railway in the full sense, or whether only a union depot company under the provisions of the Acts of the Twentieth General Assembly, Chap. 139, and its powers of eminent domain are in the charter stated in the words of this Act.

Therefore, under the last quotation from Morawetz, the Terminal Company comes within the rule and cannot make a valid mortgage of its property without the consent of the State, because of the public duties it owes to the State.

The Union Railway Depot law was passed in 1884 and is as follows:

"In order to facilitate the public convenience and safety in the transmission of freight and passengers from one railway to another and to prevent unnecessary expense and inconvenience attending the accumulation of a number of stations in one place, au-

thority is hereby given to any number of persons or any number of railway corporations or both persons and railway corporations, to form themselves into a body corporate under the general incorporation laws of this State relating to corporations for pecuniary profit for the purpose of acquiring, establishing, constructing and maintaining at any place in this State union station houses or depots for freight or passengers or for both, with necessary offices for express, baggage, and postal rooms in the same or separate buildings, railroad tracks and other appurtenances of such depots. And for that purpose may make and file for record articles of association in the manner provided for such corporations in this State, and any railroad company operating a road in this State or interested in the operation of a road in this State, whether organized under the laws of this State or elsewhere, may become stockholder in such corporation in the same manner an individual might. Such articles may provide for the business of the corporation being conducted under by-laws to be adopted by the stockholders, in which case a copy of such by-laws shall be posted in the passenger or waiting rooms of the depot and in the office of the company."

"Sec. 2. Every corporation formed under the provisions of this act, shall have power to take and hold for the purposes mentioned in section 1, such real estate as may be deemed necessary by the railroad commissioners for the location, erection and construction of their depot and its approaches, which they may acquire by purchase or by condemnation as provided by chapter 4, title 10, Code of Iowa, 1873, and when condemned and paid for as thereby provided such real estate shall belong to the corporation."

"Sec. 3. Such corporation with the consent of the city council of any city or town in this State in which said depot is located, shall have the right to lay its tracks to make necessary connection with all railways desiring to use such depot upon the streets or alleys of said city, and by and with the consent of such city council may erect such depot upon or across any such street or alley, but no railroad track can thus be located, nor can such depot be so erected un-

> til after due injury to property abutting upon the streets or alleys upon which such railway track is proposed to be located or such depot is proposed to be erected, has been ascertained and compensation made in the manner provided for taking private property for works of internal improvement in chapter 4 of tile 10 of the code, subject to the provisions of section 464 of the code."

This is the law, Chapter 139, Acts 20th General Assembly, under which the Terminal Company was organized. The title of the law is "Union Railway Depot; An Act for Union Railway Depot." No where is any authority given to such a company to mortgage its property. In the second section above quoted, it became necessary to affirmatively incorporate a provision for condemnation in behalf of union railway depot companies in order that they might secure the desired location. This right of condemnation thus incorporated into the union railway depot law is the same right of condemnation that belongs, in a more limited degree, to railroads proper, so that in order to give such companies the right of condemnation, it was necessary to enact that section, and had it been the intention or purpose of the legislature to give union railway depot companies the right of mortgaging their property, such a provision would also have been incorporated in the union railway depot law.

As to the Terminal Company, the words of Morawetz, in section 1120, apply, to-wit:

> "The same rule undoubtedly applies to any other company which has been empowered by the state to establish its works through the exercise of the right of eminent domain."

The Terminal Company has, by its charter and by the statute, the right to establish itself by eminent domain. Therefore, the Terminal Company has no authority to mortgage unless given by the legislature.

The reason for this strict rule, making such corporations

as the Terminal Company an exception in their power to mortgage, is due to the policy and determination of the state to withhold from them the exercise of powers which would result in their insolvency or in their incapacity to render the required public service.

Union depot railway companies were authorized by the legislature for reasons of greater convenience and safety to the public in the way of passenger and freight terminal facilities. The entrance of a railway into a city is always costly and dangerous to human life. In a crowded community railways are necessary evils and are to be limited in number whenever possible, and the public is therefore deeply concerned in having railway terminals so arranged as to accommodate permanently and safely many lines of railway. If the power to mortgage were vested in such companies the public would be subjected to the danger of having them wiped out of existence by foreclosure proceedings and their property and franchises diverted to other uses. A mortgage can easily be made a weapon of exclusion. Further, railway companies would not abandon their individual depots to enter a union depot except under the assurance that they would not be subject to the peril of defaulted mortgages. It is probable that the legislature considered a denial of the power to mortgage the surest safeguard against the contingency of such a company being incapacitated by its insolvency from rendering the intended service to the public. It will be presumed that the legislature designedly withheld the power to mortgage, especially as under the law such power is not implied in *quasi* public corporations of that character.

The Court of Appeals says:

> "But this (the Terminal Company) was not a corporation organized for the sole purpose of constructing union depots. On the other hand, the description

> of the general nature of its business in its articles of corporation makes no reference to any union depot, and expressly states that its business is, among other things, to construct and operate one or more lines of railway."

The Court, a little further on, says:

> "All doubt of the power of the Terminal Company to make this mortgage is, however, dispelled by the provisions of sections 1955, 1965 and 1966 of McClain's Annotated Code."

While the Terminal Company has, in its enumeration of powers, the right to construct and operate railroads as well as to construct depots and terminal facilities, it remains undisputed in the evidence that the Terminal Company has not built a railroad, nor has it attempted so to do, nor does it own a dollar's worth of railway property, unless the Court shall find that the union depot with its thirteen miles of trackage for terminal purposes, located within the city limits of Sioux City, and manifestly built under the union depot law, is a railroad. This, we apprehend, cannot be done, for the authority to construct depots with their terminal facilities, rests wholly on Chapter 139 of the Acts of the 20th General Assembly, and the Terminal Company is not "any such company" as McClain's Code (sections 1955, 1965-6) refers to in giving railways the power to mortgage.

The conclusion under which the Court of Appeals satisfies itself of the authority of the Terminal Company to mortgage, rests upon the proposition that the Terminal Company has authority to mortgage its terminal property under whatever authority it may have to mortgage its railway property if it should have any railway property to mortgage. But the Terminal Company has no railway property and the mortgage simply covers its terminal system within the corporate limits of Sioux City.

The Court of Appeals cites *Thompson vs. Lambert*, 44

Iowa, 239, 243, as sustaining the Terminal mortgage, under the idea that the powers of a corporation are as broad and comprehensive as those of an individual unless the exercise of the assumed power is expressly prohibited. This case also refers to the case of *Railway vs. Howard*, 7 Wall. 412.

The Terminal Company erected its union depot and tracks, or terminal facilities, entirely within the city limits, and in part upon its streets and alleys, under the Union Depot Act. Except for that law, which gives the power of eminent domain, the Terminal Company could not have acquired property in the heart of the city. An individual could not have built the terminal system. To acquire and develop such property the right of eminent domain was thereby given, *but only to corporations.*

The case of Railway vs. Howard, *supra*, did not contest a mortgage; and it is the power to mortgage that is disputed.

The case of Thompson vs. Lambert, *supra*, did involve a mortgage, but the mortgagor corporation therein was not a *quasi* public corporation, as is the Terminal Company. The Terminal Company, in receiving the power of eminent domain from the state, owes peculiar and important duties to the state, one of which is to continue solvent, an essential to its continued existence and service to the sovereign. This is a distinguishing fact not to be lost sight of in the determination of the authority to mortgage and especially to make this self-destructive mortgage. We understand that corporate leases have been held by this court *ultra vires* of the corporation because they merely temporarily disable the corporation from its service to the public.

The power to mortgage should not be construed into the Iowa statute (McClain, sec. 1609), as did the Court of Appeals. The fact that the state, as to railways proper only, saw fit, after the passage of the foregoing general provision,

to pass sections 1965, 1966 ~~and 1967~~ (McClain), giving to them the right to mortgage, also to enact Chapter 139 of the 20th General Assembly, and Chapter 26 of the 25th General Assembly, indicates a construction by the legislature that the general provisions did not theretofore contain the exceptional power to mortgage.

The court will note the fact that the right to mortgage either franchises or after-acquired property is not claimed under the articles of incorporation (Transcript, pp. 189–90). The mortgage (pp. 142–3) recites that these bonds are issued, among other things, to "purchase necessary grounds" for its railways and terminal facilities. It has purchased none for its railways, but has for its terminal facilities, and for union depot purposes.

The sections of McClain's Code (1965-6) relied on by the Court of Appeals, state that "any SUCH corporation shall have the power to issue its bonds," and secure the same by mortgage, but the corporations to which the word "such" refers are ordinary railways, clearly so under the context. Moreover, such power to mortgage is given "for the construction and equipment of its railway" (McClain's Code, sec. 1965), and does not in terms permit a mortgage for the acquisition of lands, and Chapter 26 of the 25th General Assembly (1894), enacted four years after the execution of the mortgage in controversy, seemed necessary in the mind of the legislature to authorize a railway corporation "to mortgage its property and franchises, in whole or in part, to secure bonds issued by it to refund or pay indebtedness, or to improve and develop its property, or for the purpose of effecting ing the object of its incorporation." A terminal company must have extensive grounds while an ordinary railroad company merely takes an easement or right of way, so that even if the statute should be sufficient for the latter it is not so for the former. It is to be presumed that the legislature

enacted these specific acts because they were deemed necessary, and they support legislative construction of the general provision as not impliedly (as it does not expressly) containing the power to mortgage. If there is a distinction between the *acquisition* of the terminal grounds, which cost a million dollars, and the *construction* of the depots and terminal facilities thereon, which cost hardly a third of that amount, none of these acts are sufficient in their language to authorize the mortgage to purchase grounds, which is a main purpose of the mortgage as therein recited. In any event, if the construction of the Court of Appeals is correct, these subsequent acts were wholly unnecessary, because included in the general statute (McClain's Code, sec. 1609), which reads, "to make contracts, acquire and transfer property, possessing the same powers in such respects as private individuals now enjoy." If these subsequent acts were necessary, then the construction of the Court of Appeals is wrong The fact that the legislature enacted them is proof that it did not construe the general provision as giving the power to mortgage.

The question here presented, however, is broader than the giving of a mere mortgage. Mortgages upon some parts of its property might be in furtherance of the purposes of the Terminal Company and its continued service to the state, but the mortgage here assailed is a mortgage of everything, property, rights, franchises and all. It leaves nothing. No lease ever more completely disabled a corporation from serving the state. The fact that a lease operates more quickly in disabling a corporation than does a mortgage should not change the rule of law, for it does not change the reason on which the law rests. The lease leaves something after its expiration, but this mortgage is certain and complete abdication. Powers in aid of the corporation may be implied but a power that leads only to self-destruction is not impli-

edly nor expressly given to the Terminal Company. This mortgage by a *quasi* public corporation is both unlawful and against public policy.

The Terminal Company has its charter from the State for the "public convenience and safety," and the due performance of its functions being the consideration for the rights so granted by the State, any contract which disables the corporation from performing them, or which undertakes, directly or indirectly, mediately or immediately, without the consent of the State, to transfer such rights and powers, is void as against public policy. The right to mortgage on the part of a *quasi* public corporation without statutory authority comes under the same rule and the same law as the right to lease. This mortgage, and especially paragraph 6 (Transcript, pp. 149-50), contains provisions that for even slight neglect or default the Terminal Company may not only be disabled but ousted. It contracts to surrender the Terminal Company, body and soul, and everything it has or may have, of every kind and nature, on slight neglect or default, to the Trust Company, a foreign corporation. Public policy does not sanction and the law should not sustain this. The cases that have reached the Supreme Court on *ultra vires* contracts have been mainly leases, but the law against this mortgage must be the same law. The Supreme Court has said that it should not be understood as holding that in a clear case of the exercise of a power contrary to public policy, a railroad company would be estopped to decline to be bound by its own act, even when fulfilled by the other party to the contract.

We submit several recent cases in this court which seem to us sufficient, under the broad doctrine of *ultra vires* and public policy, to destroy this mortgage.

Central Transp. Co. vs. Pullman's Palace Car Co., 139 U. S. 24.

Jacksonville M. & P. Ry. & Nav. Co. vs. Hooper, 160 U. S. 514.

Union Pac. Ry. Co. vs. C. M. & St. P. Ry. Co., 163 U. S. 564.

St. Louis, V. & T. H. R. Co. vs. Terre Haute & I. R. Co., 145 U. S. 393.

Oregon R. & Nav. Co. vs. Oregonian Ry. Co., 130 U. S. 1.

Penn. Ry. Co. vs. St. L., A. & T. H. R. Co., 118 U. S. 290.

Thomas vs. Railroad, 101 U. S. 71.

VIII.

RESPONDENT'S REMEDY IS TO DISAFFIRM THE CONTRACTS AND BRING AN ACTION ON QUANTUM MERUIT.

Contracts *ultra vires* of strictly private corporations are enforced on the contracts. Contracts *ultra vires* of strictly public corporations are not enforced either on the contract or on the *quantum meruit*. What the rule is as to contracts *ultra vires* of *quasi* public corporations may still be in doubt, but we submit that relief should be given, if at all, only by a disaffirmance of the unlawful contract, leaving to the party his action on *quantum meruit*. This court may well review this case and declare the law for *quasi* public corporations, a class of corporations which are constantly gaining in strength and number and which vitally affect the interests of the people. They must frequently come into conflict with public rights and public policy and the status of their unlawful contracts and of parties under them should be definitely determined. We have insisted that respondent could get nothing from a court of equity as upon its unlawful contract but that it must recover, if at all, in an action on *quantum meruit*.

This case in itself is important. Measured by the average product of men's lives, it is, in the amount involved, even vast. No court of national jurisdiction, if limited to cases

involving this sum or over, would be crowded if it heard them all. The amount involved was the statutory test prior to the Court of Appeals Act, and presumably the discretion left in this court by that act contemplated some regard for like considerations. The Circuit Court and the Court of Appeals have not decided the case for the same reasons nor upon the same basis. The Circuit Court defeated the petitioner on a statutory construction, which seems to have been rejected by the Court of Appeals. The petitioner is a judgment creditor, with his indebtedness both admitted and established; indeed, is the only *bona fide* creditor of the Terminal Company. The bondholders under their deliberately unlawful transactions cannot be considered *bona fide* creditors. The bonds were knowingly executed and taken with the deliberate purpose of violating the laws of Iowa. The bondholders get nothing in this suit save from the bounty of equity, and yet such unlawful creditors, in the bounty of equity, take everything, and leave nothing for the *bona fide* creditors. It is not written that the mortgagor can forgive the violation of law. Of what use is law? A court of equity must ever remain a court of quick conscience, as ready to smite as to succor, and equally ready to refuse relief, when to give it, would be to let the wrong-doer profit by his wrong. Creditors who participated in the violation of law have not only been given the full benefits of their unlawful act, but have absolutely displaced *bona fide* creditors. The power of this court to review may well be generously exercised.

Respectfully submitted,

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IOWA STATUTES REFERRED TO IN BRIEF.

MCCLAIN'S CODE OF IOWA.

Section 1611 is set out in full on pages 4–5 of petition.

Chapter 139 of the 20th General Assembly is set out on pages 38–40 of brief.

~~Chapter~~ See 1955: "Any corporation organized under the laws of this state for the purpose of constructing and operating a railway, may, with the assent of two-thirds of all the stockholders in interest, change the corporate name thereof. * * "

The following intervening sections refer to powers and duties of railways proper in reference to transportation of freight and passengers in the state and jointly with railroads outside the state and the public reports to state officers, etc.

SECTION 1965: "Any such corporation shall have power to issue its bonds for the construction and equipment of its railway. * * * Such corporation may also secure the payment of said bonds by executing mortgages or deeds of trust of the whole or any part of its property and franchises."

SECTION 1966: "Said mortgages or deeds of trust, may, by their terms, include and cover, not only the property of the corporation making them at the time of their date, but property both real and personal which may thereafter be acquired, and shall be as valid and effectual for that purpose, as if the property were in possession at the time of the execution thereof."

SECTION 1609: "Among the powers of such body corporate are the following:

To make contracts, acquire and transfer property, possessing the same powers in such respects as private individuals now enjoy."

Chapter 26 of the 25th General Assembly is as follows: "An act authorizing railway corporations to mortgage their property for certain purposes:

Be it enacted by the General Assembly of the State of Iowa, as follows:

SECTION 1. That any railway corporation organized under the laws of this state is hereby authorized to mortgage its property and franchises, in whole or in part, to secure bonds issued by it to refund or pay its indebtedness, or to improve and develop its property, or for the purpose of effecting the object of its incorporation. * * *

Approved April 24th, 1894."